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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE EL PASO COMPANY,
Petitioner,
v.
UNITED STATES OF AMERICA, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF AMICUS CURIAE ON BEHALF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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STATEMENT OF INTEREST[1]

The Chamber of Commerce of the United States ("Chamber") is the largest federation of business organizations and individuals in the United States. It has a total membership in excess of 245,000, including over 240,000 corporations, partnerships and individuals, as well as 1,350 trade associations, and 2,700 local and state chambers of commerce. The Chamber regularly presents

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[1] This brief is filed with the written consent of the parties pursuant to Supreme Court Rule 36.1.

its members' views to this Court and the lower federal courts on matters of major concern to the business community.[2]

The ultimate issue presented here, whether the Internal Revenue Service ("IRS" or "Service") can obtain access to a publicly held corporation's tax analysis (or accrual) workpapers, directly affects a substantial number of the Chamber's corporate members. It also concerns the Chamber's non-public corporate members, since the IRS actions in this context raise the spectre that it might take the same position with the non-public segment of the corporate community. These papers contain a corporation's "worst case" estimate of its contingent tax liability based on the issues it thinks might be raised in an audit of its tax returns, and its speculation concerning the ultimate resolution of those issues. As such, they constitute a road map to a corporation's negotiating and settlement positions on issues discussed therein.

The concern of the Chamber's members is heightened by the fact that preparation of the tax accrual workpapers is not a discretionary matter for publicly held corporations. To the contrary, the Securities and Exchange Commission ("SEC") requires publicly held corporations to periodically file audited financial statements. SEC Regulations,[3] and the standards of the accounting profession[4] require that these financial statements dis-

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[2] *See e.g., Newport News Shipbuilding and Drydock Co. v. EEOC*, (No. 82-411) (*Petition for cert. granted*, December 6, 1982); *Metropolitan Edison Company, et al. v. People Against Nuclear Energy, et al.* (Nos. 81-2399, 82-358) (*Petition for Certiorari granted* November 1, 1982); *Upjohn Co. v. United States*, 449 U.S. 383 (1981); *First National Maintenance Corp. v. NLRB*, 449 U.S. 1076 (1981); *Gould Corp. v. NLRB*, 612 F.2d 728 (3rd Cir. 1979).

[3] Regulation S-X, 17 C.F.R. § 210.1-02(n) (1981).

[4] American Institute of Certified Public Accountants, Statement on Auditing Standards No. 1 § *110.01* (1973); Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 5 (1975).

close "material contingent liabilities." The possibility of additional tax liability is normally considered to be a material contingent liability.

Moreover, the decision of the United States Court of Appeals for the Fifth Circuit below will interfere with the ability of the management of publicly held corporations to have full and frank discussions with their attorneys and independent auditors. This is of obvious concern to the large number of publicly held members of the Chamber.

Finally, the fact that the appellate courts that have addressed the issue in this case have reached differing results[5] presents difficult problems for the many Chamber members with multistate operations. It is at best an awkward situation for such multistate concerns to have their tax analysis workpapers subject or not subject to subpoena depending on the geographic location where the subpoena is sought. Resolution of these issues by this Court would eliminate the problem by establishment of a uniform national rule. For these reasons, the Chamber respectfully submits its brief.

REASONS FOR GRANTING THE WRIT[6]

SUMMARY OF ARGUMENT

Tax accrual workpapers are a corporation's estimate of its tax liability for a particular year after all tax audits, negotiations, and litigation of contested areas are completed. The workpapers are not used in any way to assist in preparation of the corporate tax return, but

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[5] In addition to the instant case there are holdings of the Tenth Circuit in *U.S. v. Coopers & Lybrand*, 550 F.2d 615 (1977), the Second Circuit in *U.S. v. Arthur Young & Co.*, 677 F.2d 211 (1982), *petition for cert. filed*, No. 82-687 (Oct. 20, 1982), and the related opinion of the Eighth Circuit in *United States v. Matras*, 487 F.2d 1271 (1973).

[6] In order to avoid unnecessarily burdening the Court, the Chamber incorporates by reference the Petitioner's Statement of the Case.

rather are created independently of the preparation of the return.

In large part, these workpapers are created to comply with Securities and Exchange Commission Regulations designed to insure that investors receive accurate data on the financial conditions of public corporations. Because disclosure of these workpapers to the I.R.S. would inhibit frank communications between corporations, and their accountants and attorneys, there is a basic tension between the policies underlying the securities regulations, and the I.R.S. attempts to obtain these documents. The significance of these policies make this case worthy of Supreme Court review.

Whether or not these workpapers must be disclosed to the I.R.S. as part of the normal audit procedure has provoked a great deal of litigation, with conflicting decisions from the circuit courts. The circuits have variously held that the workpapers are not relevant to a legitimate inquiry by the I.R.S.,[7] and that they are relevant, but are protected by a work-product privilege.[8] Because the interaction of national corporations with a national agency is at stake, these conflicting decisions should be addressed by this Court.

I. This Case Presents A Basic Conflict Between The Policies Of The Securities And Exchange Laws And The Internal Revenue Service Which Should Be Resolved By This Court.

As we stated above, SEC Regulations requiring the periodic filing of audited financial statements and generally accepted accounting principles implicitly require the preparation of a tax pool analysis (also referred

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[7] *United States v. Coopers & Lybrand*, 550 F.2d 615 (10th Cir. 1977); *see also United States v. Matras*, 487 F.2d 1271 (8th Cir. 1973).

[8] *United States v. Arthur Young & Co.*, 677 F.2d 211 (2d Cir. 1982), *pet. for cert. filed*, No. 82-687 (Oct. 20, 1982).

to as tax accrual workpapers.) Such an analysis may be prepared either by the taxpayer or its independent accountant, but in either case it must be reviewed by the independent auditor in accordance with generally accepted auditing standards. As the U.S. Court of Appeals for the Second Circuit noted in *U.S. v. Arthur Young & Co.*:

> . . . generally accepted accounting principles require an auditor to determine whether his client has put aside enough reserves to cover the contingency that, upon audit, it will owe the government more taxes than originally remitted.
>
> • • •
>
> In areas where the [Tax] law is unclear, he must predict the chances that the taxpayer's position will be upheld by the courts—a judgment based on his knowledge of the law and his opinion of where the law is headed.

677 F.2d 211 at 217 (1982). *Pet. for cert. filed*, No. 82-687 (Oct. 20, 1982).

The rationale behind this exercise is obvious. There is a strong public policy behind the securities laws encouraging the fullest and most accurate disclosure of a corporation's financial condition to investors and potential investors. The Chamber fully supports this policy, and in fact its policy manual states, "[i]t is essential that legislation which assures investors of the availability of adequate information regarding proposed issues of securities continue in force."* It is equally obvious that in order for investors to have the most accurate information, the fullest and frankest discussions must take place between corporations, and their attorneys and accountants. *U.S. v. Arthur Young & Co.*, 677 F.2d at 218-221.

But disclosure of the tax pool analysis to the I.R.S. will greatly inhibit this communication. In *United States*

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*Policy Declarations Adopted by the Chamber of Commerce of the U.S. pp. 183-184 (1981).

v. Coopers and Lybrand, a Past President of the American Institute of Certified Public Accountants testified:

> . . . I would not presume to suggest, Your Honor, that a taxpayer, be it a large corporation or a small one, be empowered in any way to withhold the facts on which they have based their income tax return or the basis on which they have computed their tax. This certainly is part and parcel of our system of self assessment, and were we to eliminate that, the Government would be terribly hampered, but what I'm concerned about is this ability of the Government to look into the client's mind to determine not what the facts are on which the tax is based, but what the worst possible nightmare is the client can conceive can happen if every assumption on which he based his tax were to go against him in some kind of litigation.
>
> He may think up contingencies even more lurid than the worst contingencies a revenue agent comes up with, and with that information available to the revenue agent just for the asking, I think eventually destroy the system of auditing that we have established because it would eliminate the freedom that the client feels of being able to muse with us about, well, what if this capital gains is treated as an ordinary income? What are the potentials? What are the chances? Well, the chances are 60-40 or 90-10, one way or the other.
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> * * *
>
> If we were hampered in any audit situation by the fact that the client knows that if he gives us any data about that its going to be readily available to Government, I cannot imagine how we would be able to render audit opinions for that client for very long. It would just absolutely cut off our communication. . .

413 F. Supp. 942 at 953-954 (D.Colo. 1975), *aff'd.* 550 F.2d 615 (10th Cir. 1977).

The decision of the Fifth Circuit below is fundamentally at odds with the holding of the Second Circuit

in *Arthur Young*, *supra*, and the Tenth Circuit in *Coopers & Lybrand*, *supra*.[10] The importance of the competing policy considerations, and the differing resolutions of the issues by the circuit courts weigh heavily in favor of this court granting review here.

II. The Fifth Circuit Erred In Holding That El Paso's Tax Analysis Workpapers Are Relevant To An I.R.S. Investigation.

In preparing a tax pool and analysis:

> . . . the auditors and corporate management engage in a worst-case analysis of the tax treatment of selected items on the corporation's return. A worst case tax assessment is then computed and a portion of this amount is accrued or reserved. *This process takes place separately from the preparation of the actual tax return*, regardless of whether the corporation also has engaged the auditing firm to prepare the corporation's tax return. (footnotes omitted)

Note, *A Balancing Approach to the Discoverability of Accountants' Tax Liability Workpapers Under Section 7602 of the Internal Revenue Code*, 60 Wash. U.L.Q. 185 (1982).

Precisely because preparation of this analysis is done independently of preparation of the corporation's tax return, and is in no way a factual predicate for the company's tax return, the analysis should not be considered relevant to an I.R.S. investigation.[11] *U.S. v. Coopers & Lybrand*, *supra*.

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[10] While the Second Circuit based its holding on the existence of a work-product privilege, and the Tenth Circuit based its holding on relevance grounds, both Courts recognized the competing policy considerations, and resolved them against the IRS.

[11] An allegation of fraud by the Service may well lead to a different conclusion as to the relevance of the analysis. But no allegation of fraud has been made here, and that question can therefore be left for another case.

The holding of the Tenth Circuit in *Coopers and Lybrand*, *supra*, on this point, which is diametrically opposed to that of the Fifth Circuit below, recognized this distinction.[12] There the Tenth Circuit flatly rejected the I.R.S.'s contention that the company's tax pool analysis was relevant to an I.R.S. audit.

In so holding the Tenth Circuit found that:

> "The Tax Pool Analysis file and related papers were not issued or compiled in connection with the preparation or filing of the [company's] income tax returns.
>
> • • •
>
> The limited purpose for which the Tax Pool was created by [the company] and communicated to [the accountants] was unrelated and distinct from [the company's] tax liability or the preparation of [the company's] tax return.

550 F.2d 615 at 618.

In holding that the tax pool analysis was not relevant, the Tenth Circuit cited the Eighth Circuit's opinion in *U.S. v. Matras* for the proposition that the I.R.S. cannot summon documents pursuant to section 7602 merely for the convenience of the Service.[13] 550 F.2d at 620-621. Quoting from the Eighth Circuit, the Tenth Circuit stated:

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[12] In this regard, the Fifth Circuit stated, "We reject the view that the tax pool analysis fails the relevance test."

[13] In *Matras*, *supra*, the Eighth Circuit stated that the test of relevance under section 7602 of the Internal Revenue Code (26 U.S.C. § 7602) is whether the sought after documents "might have thrown light upon the correctness of the taxpayer's return." 487 F.2d at 1274. Whether "light is thrown must be a 'realistic' expec-

> "If we were to accede to the government's view, it is difficult to imagine corporate materials that might not contribute to a more comprehensive understanding of the workings of the corporation, and thus, according to the government, be deemed relevant to the tax investigation."

550 F.2d at 621, *quoting U.S. v. Matras*, 487 F.2d at 1274-1275.

The Chamber firmly believes in the correctness of the Tenth Circuit's holding in *Coopers & Lybrand*, and the related holding of the Eighth Circuit in *Matras*. At the very least, however, we urge this Court to resolve the hopeless split among the circuits. For not only are the Tenth and Eighth Circuit opinions at odds with the Fifth Circuit below but they are at odds with the Second Circuit, as well. Although, the Second Circuit in *U.S. v. Arthur Young*, *supra*, ultimately determined that the Service could not have access to the company's tax pool analysis, it did so on the basis of a work-product privilege. On the question of relevance, however, the Second Circuit expressly disagreed with the Tenth Circuit and the Eighth Circuit. 677 F.2d at 218. Because the Circuits are hopelessly deadlocked on an issue of major importance to all publicly held corporations, the Chamber urges this Court to grant the petition.

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tation, rather than an idle hope." *Id.* The Court then went on to say:

> Certainly, a taxpayer should not erect roadblocks for the purpose of frustrating or preventing the I.R.S. from a full scale inquiry of the liability of the taxpayer. By the same token, the government should not for the mere sake of its convenience, impose unnecessary burdens on a taxpayer in conducting an audit or investigation for tax liability, particularly, where, as here, there is no indication of a purpose to escape any tax liability. The term "relevant" connotes and encompasses more than "convenience."

Id. at 1274-1275.

III. This Court Should Resolve The Differing Circuit Opinions Regarding The Application Of The Work-Product And Attorney-Client Privileges.

In *U.S. v. Arthur Young*, *supra*, the Second Circuit, although finding the tax pool analysis to be relevant, found "that the countervailing policies at issue in the case before us require us to fashion protection for the work that independent auditors, retained by publicly owned companies to comply with the federal securities laws, put into preparation of tax accrual workpapers." 677 F.2d at 219. In so holding the Second Circuit relied on this Court's ruling in *Hickman v. Taylor*, 329 U.S. 495 (1947), which established a policy of protecting attorneys' work product.

Although *Arthur Young* dealt with the work product of accountants, the rationale of the Second Circuit's decision applies with equal force when the tax pool analysis is prepared by the taxpayer. In each case it is necessary to balance the competing public policies of the securities and revenue laws.

Again the circuits are at odds. The Fifth Circuit essentially brushed this problem aside, finding that *El Paso* had waived the attorney-client privilege by showing the documents to its independent auditors and, moreover, that a work-product privilege did not protect the documents. Slip op. at 4155. This conflict deserves resolution by this Court. Caplin, *Government Access to Independent Accountants' Tax Accrual Workpapers*, 1 Va. Tax Rev. 57, at 80 (Spring, 1981).

The Chamber believes that there are significant policy considerations militating in favor of the Second Circuit's resolution of the problem. As a former I.R.S. Commissioner has stated:

> The policy arguments for limiting the Service's access to accountants' tax accrual workpapers are persuasive. Candid communication between accountant and client is at stake, as well as protection of the

integrity of the financial audit process and the public interest in full disclosure in corporate financial statements. An additional concern is the adverse impact of the tax accural controversy on the nation's self-assessment system. The federal income tax system is based upon cooperation by the public through voluntary compliance and self-assessment of taxes. To preserve this process, the Service must treat taxpayers in a fair, evenhanded manner, and demonstrate to the public that it is doing so. (footnotes omitted).

Id.

CONCLUSION

For all the foregoing reasons, the Chamber of Commerce respectfully urges the Court to grant The El Paso Company's Petition for a Writ of Certiorari.

Respectfully submitted,

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